

# POLICY WARNING REPORT

# Policy Warning and Forecast Report

*edited by*

**Romanian Academic Society**



***The new government in office. Performance  
assessment after the first five months***

**May 2005**

## **DISCLAIMER**

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**S**omehow unexpectedly, 2005 may become the year with the most numerous and substantial reforms per unit of time in Romania after 1989. In its first days in office the cabinet adopted a bold and business-friendly tax reform based on the flat rate, marking a strategic change in the country's fiscal policy. The property and judiciary reform package laws proposed by the cabinet in the first semester are finally putting an end to the long and protracted processes of restituting and de facto guaranteeing the property, by closing loopholes and redressing past injustice; or to the previous tendency to preserve the old habits and discredited people in the judiciary under new, EU-acceptable disguise. Standards of integrity in public life have risen with the adoption of the new declarations of assets and interests for all dignitaries, magistrates and civil servants. Media is again free to criticize the government openly, without fearing economic retaliation, which most of them do with gusto, due to the "no-hidden-subsidy" policy embraced by the cabinet in its early days. Another complex legislative package was announced for September, advancing the process of decentralization both in terms of functions and financial resources. Finally, Romania's foreign policy has become interesting again, under the energetic and unconventional president Băsescu. And we are still in the first half of 2005.

True, the sense of urgency is determined first and foremost by the tougher stance of Brussels, which demands substantial results before the country report comes out this fall. Moreover, Bucharest does not always have resources to back its new ambitions (for example, in foreign policy), and the coordination across sectors or between institutions (for instance, between the cabinet and the Parliament) is as weak as ever, which creates implementation problems. But the renewed energy and thrust are visible. This report begins by commending, in the paragraph above, the ruling coalition for its agenda and determination. The rest of the material is rather critical, aimed at identifying weak points in some of the policies mentioned and offering recommendations.

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# Foreign Policy

## THE PRIDE WELL TEMPERED

### Does the capacity of Romanian foreign policy match the ambitions of her new president?

This analysis deals with the structural problems of Romania's foreign policy, not with current events, and offers recommendations from this perspective. The problems identified are the shortage in human resources and the inconsistent personnel policy; the absence of any assistance strategy from the part of a country with regional ambitions; and a mismatch between priorities and resources.

#### The problem of human resources

Compared with her neighbors, Romania is not a small state. We are actually the largest country in the Balkans, with everything that follows from here: biggest economy, largest army, longest borders, the most numerous seats in the European Parliament. With Central Europe included, we come on the second place after Poland. Does this mean we are prepared to follow in the steps of Poles in terms of influence in Europe, courage to promote an agenda of foreign policy, and not just speak about it (in case someone did not notice, the Orange Revolution in Ukraine had two important sponsors: USA, through its many democracy-promotion foundations, and Poland, as an advanced – and somehow lonely – outpost of Europe)? If we do not strengthen substantially the basis of our foreign policy, the answer is no. In spite of the spectacular take-off of President Băsescu, who made headlines in the international media and confounded at least two or three members of hard core Europe, our foreign policy is still lacking the solid fundamentals of a serious international player. And as long as this situation lasts, nobody should be too enthusiastic about, or frightened of, our foreign policy, because we do not have resources to push our projects much beyond their launching stage.

First of all, we are short of human resource and expertise. When have you last read a good material written by someone in the Ministry of Foreign Affairs or by an independent institute, on any topic related to foreign policy, which shed a new light or came with a solution to a problem? Our scarce production in this respect is strictly formal and

void of meaningful content. Our universities do not produce regional experts. There is no specialist on Balkan issues in Romania, bar a handful of linguists, so nobody could offer informed views on TV during the conflict in ex-Yugoslavia. The same is true about Middle East, Russia, Caucasus. And things are equally dramatic in the case of EU, where we have only a number of youngsters who are still in universities there, or have graduated recently. The former opposition parties, now in power, have a responsibility for not investing in networking at the European level, being totally absorbed by their unequal political struggle with the Social Democrats (the current opposition). However, it is not their fault that Romanian universities have always cut the budget of area studies departments, or that our international relations faculties consist mainly of diplomats, lawyers and generalists, not real experts in one field or another. Who is to be blamed that every minister has to run trainings with the diplomacy using curricula copied from countries with which we have little in common, but avoids to hit the nail in the head – i.e. how the diplomats are recruited in the first place, based on clan and connections, not merit and vocation? Finally, as no regime manages to stifle entirely all the talents, some good people have made it into the ministry. But nobody makes the difference between them and the rest of the crowd, those who take an appointment in an embassy as the old Socialist writers were going on state-sponsored holidays in villas at the Black Sea, with the belief that the state owes them something due to some personal merit.

**Our embassies  
function  
largely as  
travel offices  
for dignitaries**

Without recruitment rules and long-term training programs, no difference in treatment between good and bad people, no strategic plan, and no government or non-government expert community with the practice of strategic thinking, our embassies are bound to remain travel agencies for Romanian dignitaries and visa offices for foreigners coming to Romania – and even the latter function is sometimes too much for them. The whole ministry actually is often no more than the government's travel office, although real diplomatic work should be done between high level visits, which merely stamps the accomplishments of experts and diplomats.

Second, we are short of resources and without an established tradition of foreign policy: assistance. Small wonder then that Romania made one of the smallest contributions to the relief effort after the tsunami in Asia. Effective assistance policy does not necessarily mean lots of money, and not all of them should be public funds, as Poland showed last year in Ukraine. The resources may come in the form of expertise or networking, but we are short of these ourselves and not very skilled in using them. For us, foreign policy means almost exclusively official delegations. Our involvement in Moldova may be an exception, but even there we have made mistakes with our assistance. There is no department for assistance abroad in the Romanian government and no plan to establish one. We want to assume the role of a large country and important regional player, but mentally we remain a donor recipient.

## The problem of priorities

Since we have only a few skilled diplomats, even fewer bureaucrats, and almost no experts, our capacity to prepare, debate and adopt an informed policy, and back it with an action plan is very low.

Exceptional tasks such as the presidency of OSCE stretch to the limit this capacity. So prioritization is even more important in Romania than elsewhere, because without it there are insufficient resources to reach significant goals.

If one examines the first, rather hectic, months of this administration, with the new directions launched by the Presidency, the signing of the EU accession treaty and the Iraq hostage crisis, and compares the events with the resources available (to the extent they can be assessed from outside), may conclude that our first priority is the Black Sea strategy of the president. The launching of this strategy made waves, demonstrated our willingness to become an active partner for the big actors and draw the attention to us in the Western capitals (not always to our advantage, should we say). There have been three stages in the Romanian foreign policy towards the Black Sea so far, under three different administrations, so probably the interest for this area is justified. Dan Căpățână, advisor to the former president Emil Constantinescu (1996-2000), was right to dream of the oil pipeline across the Black Sea from Caucasus to the Constanța harbor; Mircea Geoană, the previous minister of foreign affairs (2001-2004), was right to lend a hand in promoting the new Georgia to the Western world; and the current president Băsescu is surely right in drawing Europe's attention to the continent's Eastern frontier, which is very important and should not be left out of the radar screens.

But let us examine the results of these efforts. The famous oil pipeline is still a distant prospect, and so is the one by-passing Russia through Ukraine. The only certainty is the oil route through Azerbaijan and Georgia, which is why these two countries are treated equally well by Americans, even though one is a clannish republic and the other an orange semi-democracy. Since we have first begun to speak about the Black Sea project, about seven years ago, Europe's dependence of Russian energy has increased, not decreased; in natural gas this dependence is almost as high as Moldova's. As a result France and Germany are very prudent in their relations with Putin, and follow a different line on the Chechen issue than the US. The new Georgian president has allowed himself to be carried away by his early success in taking control over the rebel region Ajaria, and made the same bold move last year against the breakaway South Ossetia. He miscalculated, however, since Moscow was not very interested in Ajaria, while in South Ossetia almost everybody has a Russian passport and relatives in Northern Ossetia, which is part of the Russian Federation. Georgia backed off, and it became immediately obvious that nobody, even the Americans, was ready to support it openly against Russia. On the contrary, Tbilisi was instructed that they shouldn't rock the boat. And this happened despite the fact that Georgia is an interesting country, with harbors at the Black Sea and oil transit on its territory – of which the Republic of Moldova has none. Moldova still

**Do we have a plan for Transnistria, acceptable to the EU?**

does not have an EU representative to cover it permanently, although the matter has been discussed for some time and formally approved (no money were found). By contrast the Caucasus is full of Western diplomats and aid organizations, and the whole OSCE mission in Georgia is sponsored by the EU.

Although the advance of democracy in countries like Georgia and Ukraine play into the hand of the US, who wants to by-pass Russia and open the Central Asia's energy sources to the world market, this policy had also perverse effects. It mobilized the Russians behind their flag and made the Europeans make a step back. The EU has no reason to open new battle fields as long as they have enough problems on the existing ones, such as the Baltic countries' border with Russia or the enclave of Kaliningrad. The last EU-Russia summit in Moscow brought little progress on the big issues as far as Europe is concerned, so there is little appetite to start addressing small ones like Transnistria. Therefore our current policy to get them involved in Moldova, which is our second national priority, has at this moment the same chances as the oil pipeline of the former presidential advisor Căpățână: they should not be entirely ruled out for the future, but none is likely to happen soon.

What is left is our welcome effort to define a regional common interest. But we are not a donor country, so what can Romania do? Do we have a brilliant plan to sort out things in Transnistria, other than the economic embargo, which has never toppled an illegitimate regime? Are we prepared to persuade Moldavians to give up Transnistria in order to join Europe – or Europeans to accept a second Cyprus? Frankly, we are not. To change the European policy towards Russia, which is very much sailing against the wind, one has to be very influent in the Western capitals. Such a task requires resources and the identification of the right incentives for the Europeans if they are to go down this road. We haven't seen anything remarkable yet from Bucharest in this respect, and after the last year's victory in Moldova, when the Kozak plan was stopped in the last minute, no genuine positive development has occurred concerning Chișinău.

Briefly, our foreign policy needs much more concrete steps in all these areas, and a good management of expectations. It deserves to be supported, but do not hold your breath for immediate results – anyway, not during the lifetime of a single government. And then, can this be our first priority? No. We need to gain more influence in Europe first if the Black Sea project is to be successful. If we convince the Europeans that we know what we do and that we are able to handle this job on their behalf, perhaps we can keep them engaged in the Black Sea. After all, we must do what Poland did for Ukraine and will do for Belarus. But if we only hang on Europe's coat-tails without providing ourselves any added value, they will perceive us as merely promoting the US interests in the region and avoid taking a tougher stance on Russia just for our sake.



## **We must become more influential in Europe**

Our main priority is therefore to become more influential in Europe. Otherwise Europe will not back us in our Eastern endeavors. Right now we have serious problems with our image in countries like Germany, Netherlands or Great Britain, which are still to ratify our accession treaty, and our prime minister is not on first name terms with many European leaders when they meet in the European Council. To be more influential in the East, Romania must become a competent and respected member of the EU, but we do not qualify on any of these qualities yet. The prime minister sends shivers down our spines when he says the cabinet members must get training – not briefing – from the Ministry of Integration before they meet their European counterparts. Mircea Geoană, currently the opposition leader, also makes warm pleas, including to his own party, to send to Brussels as observers MPs who will not bring discredit to the country. Hungary, Poland and the Baltic states sent exceptional teams, often first class people recruited from outside politics.

If we want to have a decent representation in Brussels in 2008, and a reasonable level of turnout and public awareness in the first European elections, we should start to act now. Our presence in Brussels in the first quarter of 2005 was rather weak, save for the human sympathy and support mobilized by the Minister of Justice Monica Macovei during her visits. Our mission there is not active enough, ministries back home did not manage to arrive at one person per ministry who would master the whole integration file and send instead to Brussels armies of civil servants each in charge of one paragraph of the acquis. Good impact studies to help us prepare better for accession are still to be produced<sup>1</sup>.

**First priority:  
become more  
competent in  
order to be  
more influential  
in Europe**

## **Recommendations and evaluations**

Who is responsible for the shaky foundations of our foreign policy? Not the current minister, who only took office recently; and not the current president, though his ambitions make even more visible the contrast between what we want and what we can do. But the previous ministers – people of good quality, which is not the case in other departments – have all a responsibility for not taking decisive steps to solve the systemic problems mentioned above, some of which are shared with the rest of the public administration. For example, the lack of connection between performance and salary, the lack of clear standards for recruiting and promotion, the shortage of expertise and strategic capacity. In other words our foreign affairs leadership should focus not only on outflows – appointments abroad, current affairs – but also on inputs. We **recommend**, without any pretension to be exhaustive, that:

- **MFA should set up a competent strategy compartment**, which is currently missing.

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<sup>1</sup> The sectoral studies of the European Institute qualify only partly: such a study must offer an explanatory model as a basis for policies, not just descriptive analysis.

- **MFA should create a network of Romanian experts in foreign affairs in Romanian and Western universities.** It should seek to influence the study and career choice of at least a fraction of the thousands of students leaving every year for Western universities, through scholarships and contracts. When such a system was previously created (at the National Institute for Administration; and through the Government's Scholarship Program) the returning graduates were not accepted by the Ministry of Foreign Affairs. This should not happen again.
- **A genuine human resource policy should be finally** enacted in the MFA to recruit, train and monitor the career of diplomats, irrespective of who governs the country. Without such a system the promotions and replacements will remain politicized, and the diplomats will be motivated primarily to avoid annoying their bosses instead of producing results.
- **A comprehensive audit should be performed on the structure and functioning of the Ministry of Foreign Affairs,** at home and abroad, with the purpose to adjust the commitment in resources to the strategic goals adopted. The Ministry often complains it does not have enough personnel, but when comparing Romania with other small countries with a very efficient diplomacy, the numbers are not that bad. What is probably not optimal is their allocation by function and geographical area. We should ask ourselves if we really need a separate network of commercial trade representatives to promote investments in Romania, when this can actually be a performance indicator for the embassies; or whether we need so many missions in developing countries, when issuing visas can be more cheaply administered by mail.

Such recommendations are aimed at addressing the structural problems of the diplomatic machinery. But the priorities should be screened in a similar manner, clear objectives set and the overall assessment of the Ministry done against such benchmarks. Again, without trying to include all areas in our brief analysis, we recommend the following **order of priorities**:

1. **Get favorable votes when EU-Romania treaty is ratified in EU member state national parliaments.** Romania was caught on the wrong foot with the French and Dutch negative votes in the referendums on Constitution. Not the fault of Romania, of course, but neither did Romania, in its vulnerable position, lend a hand to the yes campaigns. In the weeks of intense campaigning in France, when the scare of eastward enlargement was riding high, we, Romanians, the traditional friends of France, should have been rallying behind the *Oui* camp. How could we have been so conspicuously absent? The Iraq hostage crisis is no excuse, since in a functioning state one office deals with hostages and another with the EU. Moreover the hostage crisis was managed – effectively, it seems – by the Presidency, not the government.
2. **Continue negotiations to avoid a second-class status for Romania in the EU.** It is unacceptable that with less than two years to accession

the Romanians still need a visa for Britain, for example, and there is no firm prospect of abolishing it. The arguments of the British party all concern illegal migration, so are practically irrelevant. Illegal migration is perpetuated by restrictive visa regimes. It should be tackled with targeted police measures, not general policies. After the first wave of accession a whole research literature was published on this topic, and it is surprising Romania does not make use of it to promote a more sustained offensive against the visa regimes. Generally speaking, visa policies are blind, breeding corruption and raising obstacles for honest travelers, not for the traffickers. Romania also requires visas on a number of countries that are hardly a threat, such as Australia, and did so prior to it Schengen negotiations. Until it becomes a full Schengen member, Romania should drop visas for Commonwealth countries and lobby more intensely the UK for them to abolish the visa for Romania. Or if not, claims to a special relationship should be given up.

**British visa regime should be a test case of diplomatic effectiveness**

The British visa is only one example. Here we can avoid the free labor exemptions that some old EU members plan to impose on us, longer than those applied to the first-wave countries? We should strive for better conditions on a bilateral basis with as many EU countries as possible, first because it is in our best interest to have Romanians working abroad, second because we should not get worse deals than Central European did.

3. **Prepare for a successful Romanian presence in Brussels, and improve the quality of the network of bureaucrats working on EU issues inside the government.** This task cannot be accomplished by the Ministry of Foreign Affairs alone, therefore the work must be done in cooperation with the Ministry of Integration, the PM office, political parties and the civil society. However, MFA can and should be the spearhead of this initiative.
4. **Create a strategy for the Europeanization of the Black Sea region.** This cannot be done overnight with the level of expertise currently available in Romania – but on the other hand, six months after the initial idea was launched, it is hard time to feed it with more than just speeches. No clear action plan exists and this new direction of Romanian foreign policy risks remaining on paper only.

The new stress of our foreign policy, as presented by president Băsescu draws on a higher awareness of Romania's weight in international affairs and on a renewed national pride. And we support that. However, the president should also understand that teachers encourage assertive students when they are the best and brightest, not when they are laggards. A cabinet with ministers who need basic training in EU affairs is not likely to impress anyone in Brussels. Moreover, this boldness fits well the president, who is elected by the majority of Romanians, but not necessarily every Romanian politician or bureaucrat, irrespective of age and position, who risks being perceived as arrogant. To support our new regained pride we need to increase our competence. Our pride is well-deserved: we fought against an attempt to steal our 1989 revolution; we did not resign with

our corruption even when some representatives of Europe appeared to turn a blind eye, and we have made a terrific journey from the country of Ceaușescu to the one that signed the EU accession treaty last month. However, this pride should be tempered by the awareness that there is still a very long way to go for our third-rank sized country to attain a first class foreign policy, on the model of small countries like Sweden, Denmark, Switzerland or the Netherlands.

# Fiscal Policy

## THE FLAT TAX WORKS

**As SAR predicted two years ago that it would**

In August 2003 SAR initiated a series of publications in support of the introduction of the flat tax in Romania. For one year and a half we campaigned forcefully for this idea – more precisely for: (i) eliminating the progressive taxation on personal income; (ii) broadening the tax base, by including as many sources of personal income as possible under the coverage of the single flat tax; (iii) eliminating the existing and proposed exemptions; and (iv) reducing the rate on corporate profit in order to align it with the new personal income rate. Other organizations and opinion leaders picked up on this idea, and even the previous Social Democratic government contemplated it for a while, until the conservative wing of the party struck it down thinking it may be unpopular with their voters. During the electoral year 2004, however, the center-right opposition alliance, encouraged by our campaigning and the public acclaim that greeted the same type of fiscal reform implemented in Slovakia, decided to make the flat tax a central piece of their electoral campaign.

After the fiercely contested elections of November 2004, several weeks were needed to sort out the cliff-hanger. Eventually the center-right alliance emerged as a winner (somehow to its own surprise), and moved swiftly to form the government. There was not much time for policy analysis: the cabinet was sworn in on December 28<sup>th</sup> and they had to adopt the fiscal reform package before the end of the year in order for it to become effective in January 2005, and not one year later (under the “stability” provision of the Code, any substantial amendment applies only beginning with the following calendar year).

As a result the changes were discussed and passed as an emergency ordinance in the last days of December. They were centered in the hallmark figure of 16%. The idea was to bring down to this level the taxes which were above it, and increase those below it, in order to make the whole system more neutral and entrepreneurial-friendly. The most important and visible direct taxes in Romania were both substantially reduced: on corporate profit from 25% to 16%; and on personal income by abolishing the old progressive scheme with a marginal rate of 40% and replacing it with a flat one of, *bien sûr*, 16% (Fig. 1). Simple and neat, to the delight of any Western conservative think tank and the despair of some EU governments.

On top of that, a whole range of deductions and exceptions were eliminated (some of them only proposed by the previous government, but never actually applied), for both direct and indirect taxation. And the tax on gains from interest or stock market transactions was raised from the previous level of 1%, while the special turnover tax on micro-enterprises doubled, from 1.5% to 3%.

**Fig. 1. The fiscal reform of January 2005**

	<b>Before</b>		<b>After</b>
Corporate profit tax	25%		16%
Personal Income Tax	18%	up to 60 €/month*	16%
	23%	up to 150 €/month	
	28%	up to 230 €/month	
	34%	up to 325 €/month	
	40%	above 325 €/month	

\*average salary in 2005: 240 €/month

After only four months since the reform was introduced it is too early to pass a final judgment on the success of this policy. Moreover, the package is still not perfectly neutral since intermediate transitory regimes with rates lower than 16% were accepted for a period of one year for gains from bank deposits, dividends and the capital market, while the special tax regime for micro enterprises will be phased out until 2007.

**Budget  
revenues have  
indeed  
increased after  
the tax cuts...**

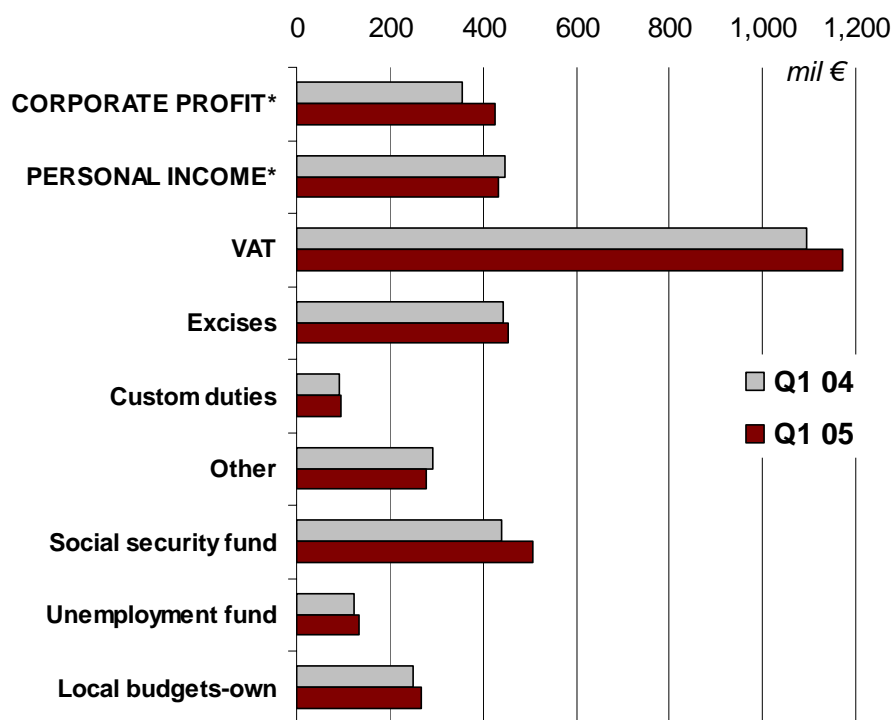
Still, there are strong signals that the flat tax works, in Romania like everywhere else, as SAR has argued all along. The *Laffer effect* of the rate reduction is most visible in the case of the corporate tax, where obviously the supply side theory functions (Fig. 2). But even in personal income the drop in collection is much smaller than what the government – and, especially, the IMF – expected after such a significant drop in rates. The overall increase of revenues to the state budget, in real terms, in the first five months of this year against the same period of 2004 is 4.7% (Fig. 3).

Moreover, the increase above the rate of inflation of the sums collected at the Social Security Fund (Fig. 2), where contributions are defined as fixed percentages of the salary, suggest that some jobs have indeed moved from the underground into the official sector and started to pay income and wage taxes to the budget. The authorities estimated their number to about 100,000. If correct, this represents a 2.5% increase for the official sector, achieved most likely at the expense of the informal one.

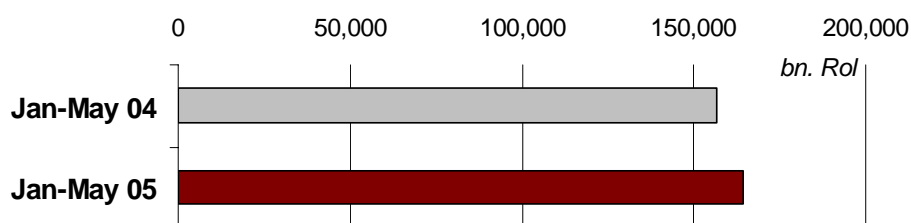
**Fig. 2. General consolidated budget, before and after the fiscal reform**

Real terms: inflation discounted, fixed 2004 exchange rate

\* the tax rates modified by the fiscal reform



**Fig. 3. Total revenues of the state budget (unconsolidated), real terms, first 5 months**



A second positive effect which is hard to measure exactly comes from the elimination of the tax return forms and the reporting procedure for the employees who have just one source of personal income. Out of the 2.9 million taxpayers with reporting obligations in 2002, it is estimated that around 80% will disappear from the system following this simplification. Starting with 2006 all these people will stop submitting forms to the tax authorities, therefore time and administrative effort will be saved in both the public and the private sectors. However, these benefits will only accrue in the following years.

## Problems

A lot of the criticism following the fiscal reform and directed at the Ministry of Finance was, in our opinion, wrong-headed. When the opposition and the media denounced the "tax increases that offset the effect of the flat tax", this was largely a knee-jerk reaction based on a superficial understanding of the principle of fiscal neutrality. As we showed above, prior to these changes the capital gains or gambling were much less taxed in Romania than salaries, which was absurd. What is more, the existing and planned exemptions were benefiting mostly people with high or multiple sources of income. The reform did indeed reduce the average tax burden, while in the same time broadening the tax base by eliminating these exemptions and the disproportionately low rates on certain sources of income. It is the merit of the government that they withstood the pressure of interest groups (for example, the producers of goods and services that were VAT exempt) and invested a lot of political capital in this reform.

Having said this, it is also true that the changes were not well managed by the cabinet and a lot of uncertainty was generated by the hesitant actions of the Ministry of Finance and the lack of support by some top government officials. Time pressure is an explanation, but not an excuse, for the erratic implementation of the fiscal reform.

- While the general idea of the reform was clear from the beginning for whoever wanted to see it, the specifics included in the secondary legislation came long after January 1<sup>st</sup>, when the Fiscal Code was supposed to become effective. In fact, some parts of the Code come into effect only at the beginning of June, after the Parliament discussed and amended it in several sections.
- Even more serious than the delay are the loopholes introduced by the Parliament in the regime of taxing the gains from real estate transactions (introduced for the first time). By amending the law in key points they created the possibility for real estate owners to play with the date on the contracts, or set up transfer schemes between individuals, or individuals and companies, so as to avoid the tax on gains completely. Since in Romania politicians are often blamed for enriching themselves by accumulating land and buildings, it is difficult to regard these amendments as honest mistakes. Unless these loopholes are closed the budget will not collect probably very much from this new tax component – but will not lose either, as this class of personal gains was not taxed before.
- The lack of coordination across sectors and agencies is a typical problem in Romania, which could not be averted on this occasion. When they operated the changes to the Fiscal Code, the government overlooked the fact that the personal income tax is a shared source of revenue for the local governments, out of which they receive a fixed percentage. The drop in collection predicted immediately after the introduction of the flat tax was going to impact local budgets negatively. So in February the government decided to intervene with an emergency ordinance and increase these percentages significantly. But we see today that the drop

**... but some aspects of this reform were poorly managed; some gaps in coordination will create effects in the future**



may not be as severe as initially thought, so it is possible that local governments were over-compensated (though any mayor would argue that, if this happens, the extra sums barely cover the unfunded mandates they have received from the center in the last years).

- Finally, it is good that the government mustered their courage and made the long-postponed step to increase the tax on agricultural land, from the symbolic sum of about 30 Eurocents/ha/year, to an average of about 10 Euro/ha/year. However, with no reasonable explanation, they decided to withhold this sum at the central budget, although property taxes have always been own local government revenues in Romania. Not only does this measure contradict the principles of decentralization upheld by the ruling coalition, marking a reversal of trend and clashing with the draft legislative package scheduled to be sent to the Parliament this fall – but it may create perverse and uncontrollable effects too. Mayors have threatened that, if the measure is not abolished and they do not get their money back, they will propose the Local Councils to incorporate all the agricultural land into the "inhabitable area" of the locality, and thus continue to collect the tax at the local level. If they do this, a lot of zoning plans would become irrelevant and the building sprawl much more difficult to control.

# Agricultural Policy

## AGRO POLICIES, ELECTORAL CYCLES AND THE EU ACCESSION

### What the current administration can and should do in agriculture

If we look at its broad policy objectives, the current Romanian government that took office in December 2004 has laid out one of the clearest programs after 1990 regarding agriculture. However, the measures announced for implementing this strategy are not so clear, and some are inappropriate. Moreover, no difference is made in the governing program between the pre-accession years of this mandate (i.e., until 2007 or 2008) and the post-accession ones, when some things will have to change as a result of the need to comply fully with the Common Agricultural Policy (CAP). It is still not too late to inform all beneficiaries, large and small, about the changes that will occur from 2007 on, especially in the regime of subsidies. The new minister may have referred precisely to this when he announced the subsidization will have to change starting with the fall of 2005, but since no details were offered it is hard to tell.

### The new property laws

The pro-active attitude of the new cabinet is apparent from the first point in their governing program: the completion of the process to reconstitute land property to previous owners. A legislative package was already drafted to this effect, including amendments to all major property acts passed after 1990 – Law 18/1991 (the land law) and Law 1/2000 (the “law of Vasile Lupu”) – in order to remove part of the vast quantities of pork and barrel included. Also on the list are amendments to Law 7/1996 (cadastre), updating Law 54/1998 (the legal circulation of land), and a new law to speed up in courts the cases related to land property restitution. It is very encouraging that all these changes incorporate a lot of feed back from practitioners and that they were put up for public consultation before being sent to the Parliament.

However, due to the fragile majority in both chambers, it is still possible that the new amendments do not pass, unless they are rushed through in the same time with the larger package of property restitution on which the government intends to follow the riskier path of assuming

responsibility<sup>2</sup>. The foreseeable impact on these laws is not going to be high on the short term; the symbolic impact is however important and likely to shape the long-term effects of the laws.

### Encouraging family farms

The second objective of the government's agricultural policy is to "stimulate the transformation of peasant households into commercial family farms", and as a result "develop and consolidate the middle class in the Romanian rural society". If we are to believe the statements of the ruling coalition's leaders, this is in fact *the most* important objective of this strategy. The means by which it will be implemented are: the encouraging of land consolidation through exchanges and free market transactions, support for livestock farms, and the introduction of a life annuity for old peasants who give up their lands. There are no specific policy targets on this objective, but it is also true that such targets would be very hard to define given the complexity of the process to transform peasant households into commercial farms, and the deep historical entrenchment of the former in the Romanian society.

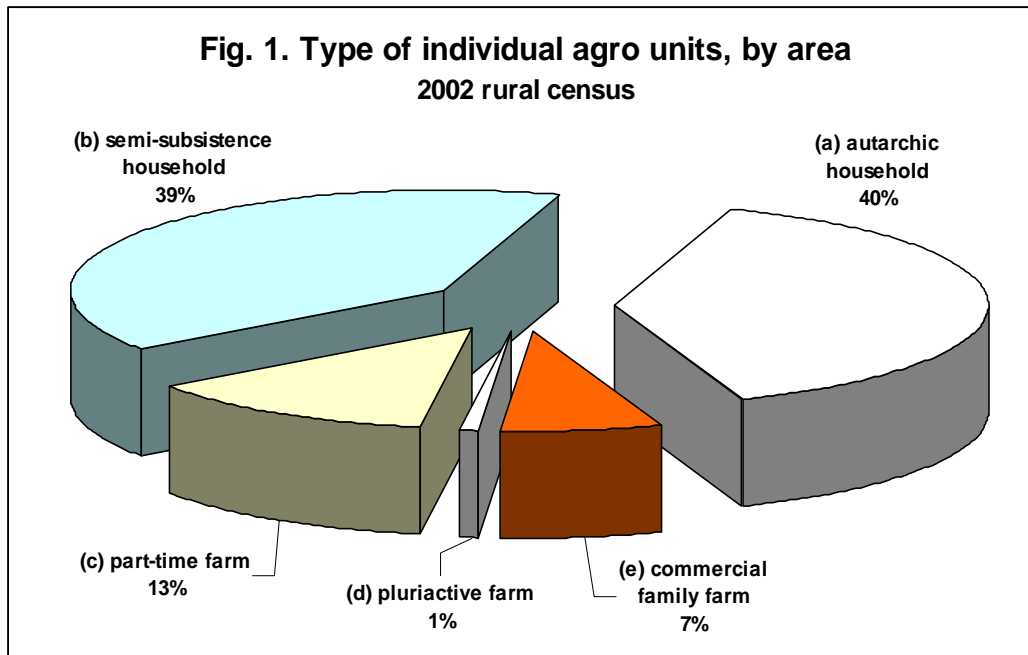
The peasant household is characterized by a very imperfect integration with the formal agro markets, which themselves are sub optimal. For these traditional households the inputs and agro-food markets are not essential as long as they rely mainly on self-consumption; the capital and land markets are fragmented and shallow; the low stock of human capital prevents them from using new information and technologies; and the labor market is rigid, favoring rural underemployment and low productivity. If a strategy to turn peasants into farmers is to be successful, all these dimensions have to be taken into account.

The sheer size of the problem that needs to be tackled is impressive and singles out Romania among the new EU member countries. Fig. 1 presents a breakdown of the 4.4 million individual agro units in Romania, occupying 8.4 million ha, which means more than half of the arable land. As the chart shows, traditional peasant households (autarchic and semi-subsistence) represents the vast majority among these individual units in terms of area, allowing little room for farms producing for the market (c, d, e). All in all, there are only 92,000 individual farms producing for the market. These two types of traditional units identified at the 2002 rural census should be targeted with slightly different instruments: "autarchic" households (about 3.4 million) should be offered early retirement or life annuities for giving up land; the "semi-subsistence" households (about 1 million) should be offered micro-grants for investments. Both instruments involve public funds. The 2005 budget does not have such kind of money earmarked, but if a decision is made quickly there is enough time to prepare for having them ready in 2006.

**"The peasant issue" – that of subsistence rural households – is still unsolved after one century and a half of attempts**

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<sup>2</sup> Fast track procedure to cut short the parliamentary debates and go directly to the vote on a bill; if it is rejected, the cabinet resigns.



Life annuities for peasants older than 60 who agree to sell or lease out their land is one of the most debated topics in Romania today. The level of compensation proposed by the government is 100€/ha per year for selling, and 50€/ha per year for leasing. The problem is, we do not know yet if this measure, if implemented, can remain in place after Romania's accession into the EU. What is clear however is that in any case it cannot be financed with community funds, before or after accession, since the EU has a different scheme with the same purpose but different rules: early retirement, applicable not only to land owners but also to agro laborers. In this scheme the age limit for becoming eligible is lower (55) but the annuity is paid only for a maximum of 15 years (10 for laborers), and not beyond the age of 75 (which is the legal retirement age for agro laborers in the EU). In case the Romanian scheme is accepted by the EU, they can both function after 2007, but only if the national budget can fully fund the first one. Alternatively, they could be implemented in succession, one before and the other after joining the EU, in which case a large-scale publicity campaign should be initiated as soon as a decision is reached so that Romanian peasants understand what the whole plan is and choose the moment when they want to opt in.

Five-year grants up to 1,000€ per year per household will also be available after accession as support for semi-subsistence households (b type in Fig. 1). But the farmers will have to submit a business plan to prove their exploitations are viable in the long run. The corresponding measure currently in preparation at the Ministry of Agriculture is the "Farmer" Programme to encourage young and better qualified people to settle in rural localities. When it comes to be implemented, the most serious obstacle will probably be the selection of these young families.

## Reforming the subsidies

Under the guise of two new objectives – “efficient allocation of budgetary resources for supporting agro producers” and “support for selling the products on the market” – the current governments intend to continue with the subsidization system inherited from the previous administration, operating only marginal adjustments which are not necessarily beneficial. The continuity is apparent in terms of both pluses and minuses. First, there is a heavier reliance on support for investments and a certain movement to align the domestic policies to CAP; but on the other hand, the tendency persists to yield easily to the pressure of various interest groups, manage the subsidies sloppily and continue with measures that utterly contradict the CAP (such as the subsidization of irrigations or diesel fuel).

Although most of the strategies and preambles to the subsidization plans implemented after 1999 mentioned explicitly that they were CAP-compatible, today we can see that none of them was. And this is also true for the measures initiated after December 2004. This is why we believe it is inappropriate that, starting in mid 2005, the subsidies paid by the Ministry of Agriculture be distributed through the recently created Payment Agency, as some officials declared. This would be a diversion of human and material efforts from the strategic goals of preparing for accession, and a waste of the most limited resource today in the process of setting up the institutions for post-accession funds: time. Instead, the Agency should run at least one measure which is fully compatible with the CAP in order to test and adjust its mechanisms. Direct payments, EU-type could be such a measure, if due attention were paid to establishing the Integrated Administration and Control System (IACS), which is already beyond schedule. Without a functioning IACS at the moment of accession there will be no direct payments in Romania. This may trigger an absorption crisis, since these sums are larger than those for the market support measures.

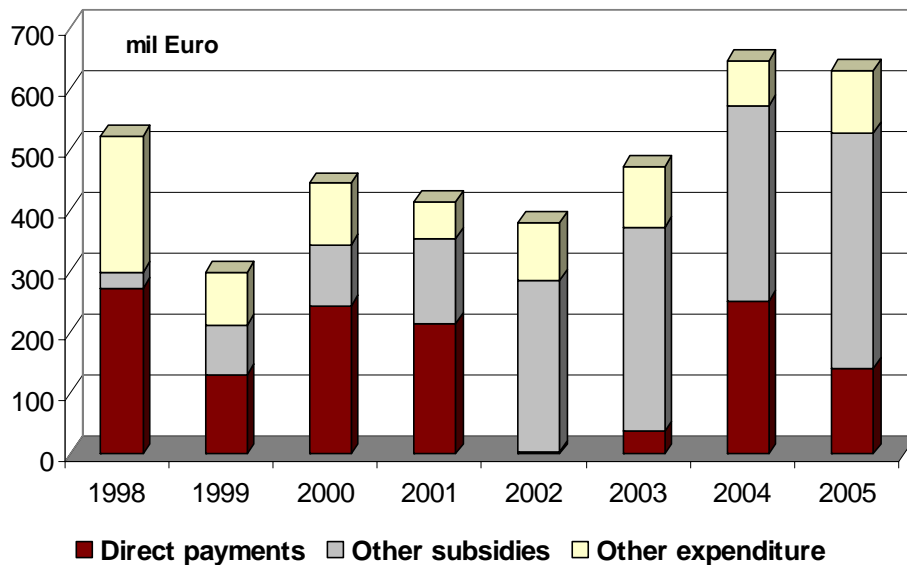
**The current system of subsidies is not compatible with the CAP**

This is also true for our national budgets in the last years: a sizable share of subsidies come in forms that resemble the EU direct payments, which in our case means cash in hand or vouchers for peasants (except in 2002 – see Fig. 2). The problem is, none of them meets the CAP criteria of eligibility of beneficiaries, monitoring of disbursement and timing. For example, the true direct payments in the EU are made at the end of the farming year, not at the beginning or during it like in Romania, where subsidies became a soft financing instrument for the agro season. Moreover, the Romanian vouchers represent a subsidization of inputs, which again is not accepted under CAP.

The Romanian authorities can probably argue that, at least until 2007, they need to continue with the vouchers as a “dirty” form of direct payments, for many practical reasons. The large diversity of goods and services that can be paid for with vouchers ensures that the markets for inputs will not be distorted too much. Second, but only off-record, they can show that the current voucher system helps to diminish the pressure on the budget at sensitive moments of the year (for example in the spring of 1999 when Romania was near default; or at the

beginning of 2005 when the situation was uncertain due to the fiscal reform). This is so because the voucher clearing mechanism delays the actual payment by a number of weeks; even longer delays can appear due to the bureaucracy, but nobody complains because there are “sweeteners” such as the partial payments included in the price of inputs. Without these informal delays, direct payments should have been made in March-April, which is not the most comfortable period of the year for the state budget.

**Fig. 2. The budget of the Ministry of Agriculture**



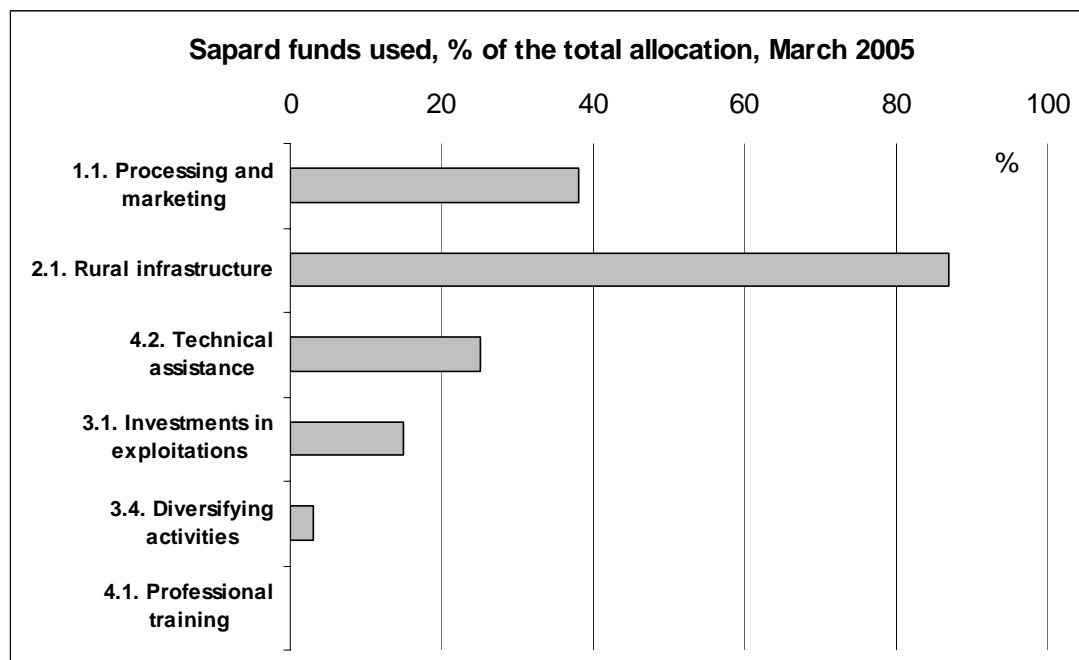
All the other types of subsidies must be replaced by 2007 with CAP-compatible ones – in market support, mainly subsidies for cereals, beef and sugar – or completely terminated – such as subsidies for pork, poultry, and for inputs like diesel and irrigations. It is therefore obvious how inappropriate it was to reintroduce in 2005 the price subsidy for diesel fuel, courageously eliminated by the previous government, and the subsidies for pork and poultry, which do not exist in the EU. Looking at the main beneficiaries of these measures, which are the large industrial producers, we can infer the golden rule of thumb that their lobby is more effective the more the political leaders are beginners and the top civil servants in the Ministry old and experienced. In March 2005 the Agro Producers Association was formed, bringing together 40 large agro business operating 350,000 hectares. In consequence the struggle for public subsidies between large companies and small farms can only become harsher until 2007, when as a result of joining the EU the balance between the two types of agro units will be imposed by the agreements reached at the European level.

## Promoting rural development

Rural development is the second pillar of CAP in the Union, swallowing almost as much money as the agricultural pillar itself. In Romania the notion was included in the governing program under the label “development and modernization of villages”. The proposed actions are a list of the main measures included in SAPARD, plus a number of specific elements aimed at facilitating the absorption of the community funds. The emphasis is on infrastructure and diversifying the rural economy.

**Fig. 3. The state of accessing SAPARD funds, March 2005**

Measures	Applications	Contracts	Payments made, mil €	% allocation used
1.1. Processing and marketing	213	149	4077	38
2.1. Rural infrastructure	1354	607	26403	87
4.2. Technical assistance	16	13	37	25
3.1. Investments in exploitations	364	268	702	15
3.4. Diversifying activities	309	201	105	3
4.1. Professional training	1	1	0	0



The rate of success in contracting SAPARD funds is very uneven across the accredited measures. The most sought after are the rural infrastructure projects (see Fig. 3), and the authorities seem resigned to this situation and tacitly accepting that the other allocations will not be used fully. After three measures were certified in 2002 (1.1., 2.1. and

4.2.) and three more at the end of 2003 (3.1., 3.4. and 4.1.), the overall rate of absorption remains low: 74% for the money allocated in 2000 and 2001 on the first three measures, and 9% for the money allocated in 2002 for the other three.

A thorough analysis of the factors that influence the success of SAPARD is urgently needed, since the problems the system is facing now are likely to be reproduced on a larger scale with the biggest sums coming after accession. This analysis should focus not only on the issue of the absorption rate, which is a very imperfect success indicator, but also on the impact of implementing the projects, i.e. the magnitude of structural transformations taking place in the rural area as a result of the EU assistance. However, since a good rate of absorption is a necessary, though not sufficient, condition of success, quick action must be taken to reduce the share of funds not contracted by the end of 2006, because they cannot be used after this date. Equally important is the proper functioning of the SAPARD Agency until 2007, on both its operational and monitoring functions. The latter was rather overlooked so far, especially in infrastructure projects, which partly explains the higher rate of utilization of funds on this component – and may announce future problems of integrity.

### **Getting the institutions in place**

There is a special objective dedicated to “improving the institutional framework” aimed at preparing Romania for implementing the CAP. The key components of this framework are both new bodies such as the Payment Agency, the Management Authority for Orientation Funds, the Agro Accounting Info Network; and existing ones like the Veterinary and Food Safety Agency, Agro Consultancy Agency and the system of agro statistics.

While the veterinary and fito-sanitary components are more or less on schedule, other components are in various states of delay that threaten to become critical. The layout of the Payment Agency was only defined by ministerial regulation in February 2005 and it is not functioning yet. The same situation with the Integrated Administration and Control System (IACS), which is part of this Agency: if by the time of accession it is not in place and fully functional the market support measures and the direct payments cannot be made (all eligible plots of land need to be identified beforehand). IACS relies on a number of technical sub-systems such as the one for registering plots, livestock and the rights of payment. Their implementation requires time, investments and proper training, which cannot be done in haste at the end of 2006.



# Regional Development

## CONVERGENCE OR DIVERGENCE?

### Regional disparities in Romania and the effect of moving closer to the EU

In Romania the transition to market and democracy was more difficult and traumatic than in other CEE countries due to the severe distortions inherited from the communist regime. The attempts to distribute more or less evenly industries and wealth over the whole territory of Romania, guided from Bucharest and constituting explicit policy for many decades before 1989, led to perverse effects: over-investment in prestige projects and under-investment in infrastructure and human capital; industrial white elephants; the emergence of mono-industrial towns or areas, relying on a single large company for their whole socio-economic life; and a network of cross-subsidies between branches and regions that made impossible to know what was economically viable and what not. Moreover, beneath the surface of this formal socialist economy paraded as modern and booming, the social structure of "deep Romania" has endured more or less unaltered, having at its core the autarchic peasant household. Semi-survival, traditional agriculture on small plots was practiced by the members of agro cooperatives alongside – or at the expense of – the official state agriculture; but also by a large proportion of the industrial workers who were in fact semi-urbanized peasant commuters, more attached to their land and garden than to the factory that paid their salary.

The economic restructuring with partial dezindustrialization after 1990 was an obligatory stage in which some of these distortions and over-investments were eliminated. Without the pressure of international financial institutions or the EU, things would have probably gone in the same direction, only more slowly and hesitantly, with all the political slippages that usually accompany such a process in societies incompletely modernized (and which were not entirely avoided in Romania anyway). Today, after fifteen years of transition and ten years of approaching the EU on fast forward, a number of conclusions are discernible regarding the relative potential of development of different Romanian regions. Summarizing the **factors that determine the wealth and dynamism of our regions**, one can say that:

- Old, historic disparities in development level could not be erased by the massive efforts and investments, lasting decades, under Communism. The regime only managed to create an appearance

of social homogeneity and some unviable economic units which disappeared as soon as the protecting glass case was removed.

- The divergence between regions after 1990, apparent especially during economic booms – the richest ones grow faster than the poor ones in good years, and decrease less during recessions – is therefore largely a reflection of the pre-Communist times.
- Apart from inherited development and its pre-requisites, additional factors influencing regional growth seem to be today: geographic location (the closer to the Western border, the better); and easy access (the cases of Bucharest, or the city of Constanța at the Black Sea; or sub regions that grow faster than others within the same region).
- Demographics will matter in the future in a way that is completely new for Romania, reproducing trends that occurred after World War II in some parts of Western Europe. And it is not only the general population decline which we share with many EU member countries – but the pronounced aging process, probably followed by depopulation, in vast rural areas of Southern Romania. Economically such a process makes some sense, but many social problems will have to be solved along the way for which we are not prepared.

All these factors are exogenous to governance and lead to the pessimistic conclusion that, ultimately, the patterns of development in Romania are largely pre-determined. There are no success stories of policy interventions that managed to change them between 1989, in Romania or elsewhere in CEE – and such success stories are even less likely to appear after Communism, when the scope and instruments of social intervention were substantially reduced. The hope to spread around development with the help of large infrastructure projects, so much discussed in Romania today, is overblown and a bit naïve. Because ultimately they will be prioritized so as to serve economic activities where they already exist and feel constrained by the existing network of transportation and utilities. It can hardly be otherwise, since the theory of planting highways in backward regions in order to generate development is a poor investment strategy in terms of cost-benefit, and is in general honored more in rhetoric than in reality, especially in a poor country like Romania.

In other words, development is too complex and elusive to be generated top-down by government policies, even well-meaning ones. It resembles a living body easy to destroy but hard to regenerate from scratch. Creating a favorable environment for it is one thing the governments can do, and here we come to the orthodox package of competitiveness, functional bureaucracy, low corruption and stable institutions. But there is precious little beyond this that has proved useful in the long run. Moreover, the laws and the business environment are in general determined at the national level, so there is not much a mayor or county councilor from a poor region can do to push things in the right direction. (The converse is not true, however: they can do a lot of harm if they want; so a useful advice would be, don't ruin with wrong-

**Geography  
and historic  
legacies still  
play a  
determinant  
role**

headed local policies the little growth that is happening naturally in your community).

Therefore development appears to be easier to approach as an object of measurement and evaluation by analysts than a policy target for decision makers. A Hungarian economist has calculated recently that in our region development advances from West to East at a pace of about 20-30 km per year. If we accept this sketchy but beautifully graphic description, take as starting point the Austrian border and initial moment the late eighties, when Hungary launched its pro-market reforms, the sustained growth of the Western parts of Romania in the last years fits well this model of a progressing wave.

On the other hand, the truly historical novelty in our part of the world is the process of EU accession. There has never been in Central and Eastern Europe such a consistent and institutionalized foreign intervention before, with technical, financial and political components, and with the declared aim of development. The *crescendo* of assistance in the last decade will reach a climax with Romania's accession in 2007. If there is something that can alter the old patterns of regional development, probably here is the hope. Which does not mean that things will run on automatic pilot once Romania joins the Union and money starts flowing in even larger quantities. For every Ireland which used intelligently the EU funds to shape up itself and become a modern country, there is a Southern Italy which did not, burying them in useless projects and reinforcing the closed and cronyist traditional society. It will be our choice and responsibility to follow one of these two models, because Europe can provide money and some safeguards that not all of them will be stolen, but cannot guarantee the impact of their spending in the deep Romania.

An extra glimmer of hope comes from the opening of the European borders for Romanian citizens in 2002. This was arguably one of the most significant changes for ordinary Romanians in the decade and a half of transition, with a positive impact still hard to quantify. The massive circulatory migration between Romania and Western Europe in the last three years has brought into the country more money than the official assistance through pre-accession instruments or FDI<sup>3</sup>. There are signs that fortunately the benefits from this migration are relatively evenly distributed by social categories and regions, which contributes to convergence; this was not the case before the Schengen visas were abolished.

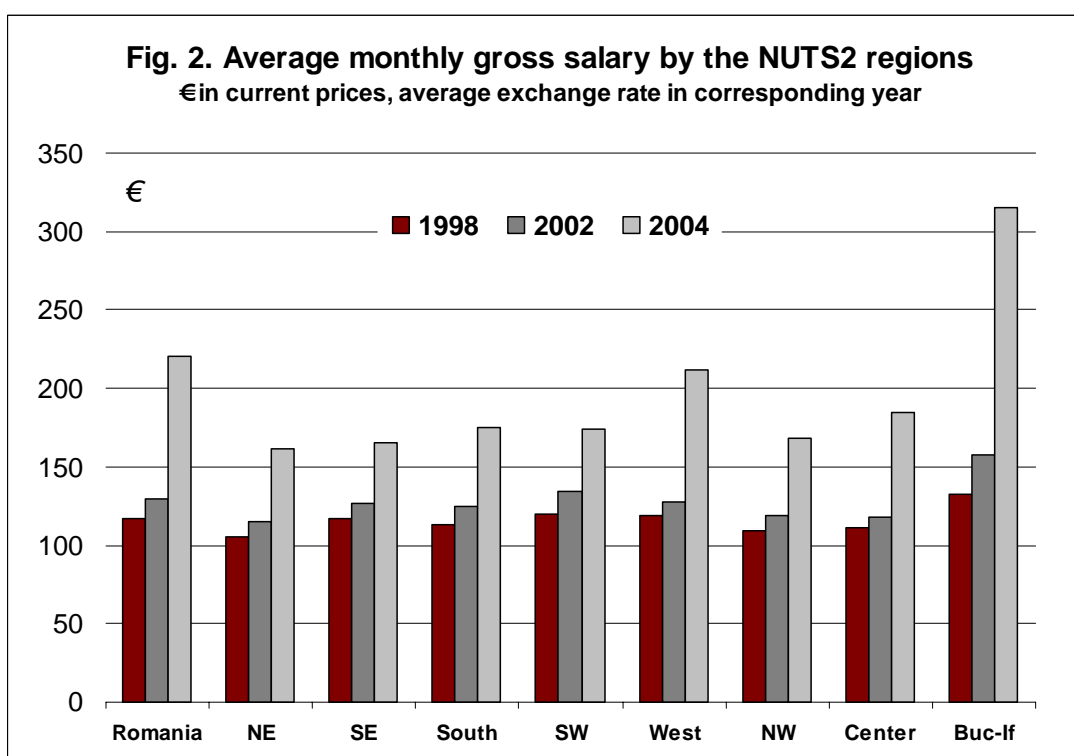
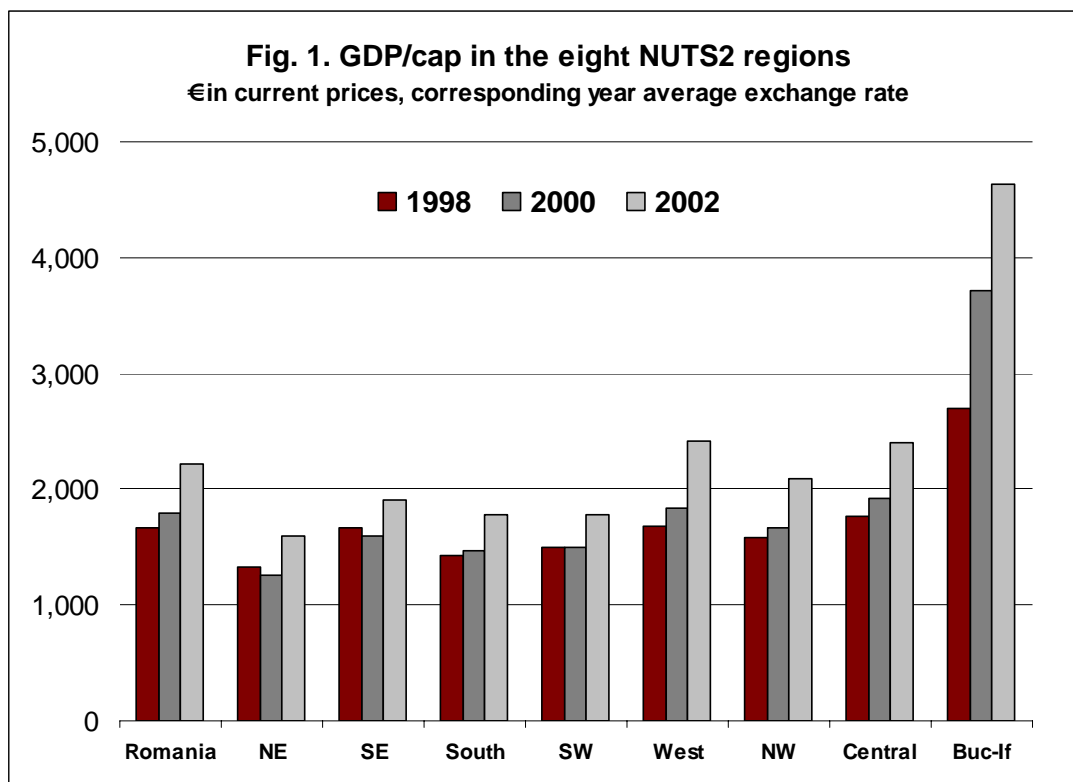
### **Patterns of development**

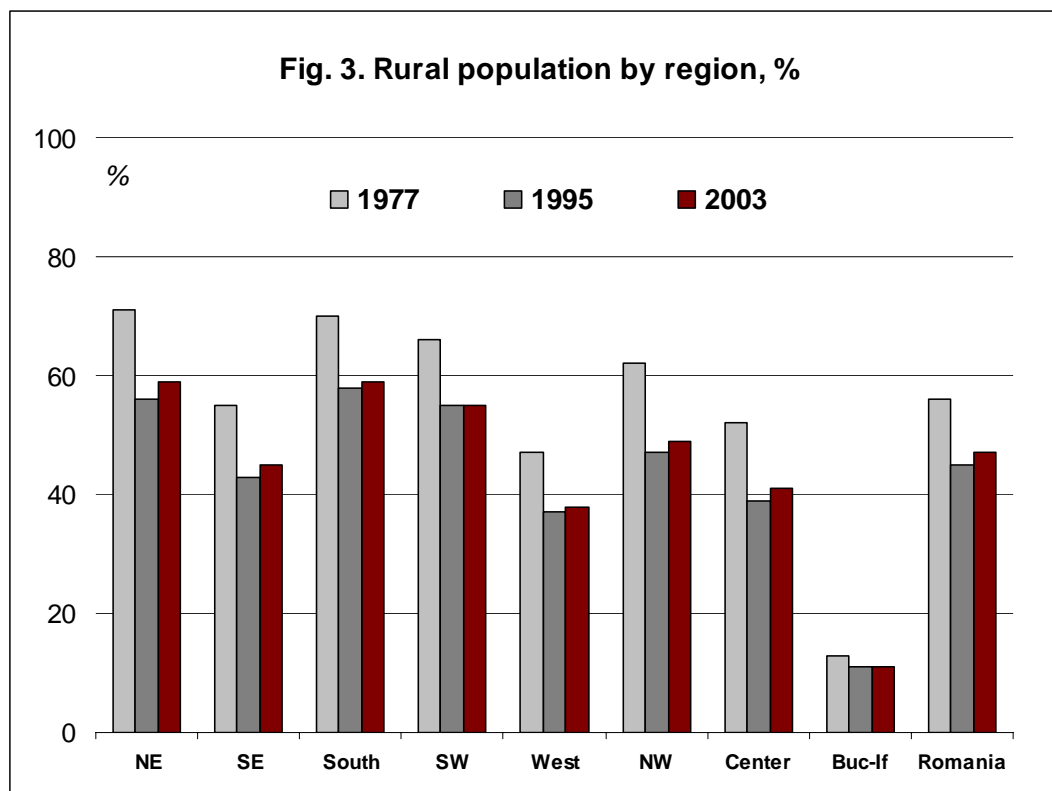
GDP/cap rose in Romania in real terms, but unevenly across the eight regions (Fig. 1). Region 8 (Bucharest-Ilfov), with its special profile, benefited the most, followed by the Western parts of the country and Constanța county (which pushes up the average in South East). Since 1998 Region 8 has probably doubled its GDP/cap, which is remarkable

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<sup>3</sup> SAR is currently carrying out a research project on the topic on migration to EU and its effects on local communities; a report illustrated with case studies will be published in the fall.

progress: adjusting up the numbers with the Purchasing Power Parity (PPP), it approaches rapidly the EU average. The average salary displays the same trend (Fig. 2), though less pronounced: salaries in NW and the Central region are not as high as the GDP level would predict, and this gap may be explained in many ways, from the concentration of the state mining sector in SW to the variable share of the underground economy across regions.



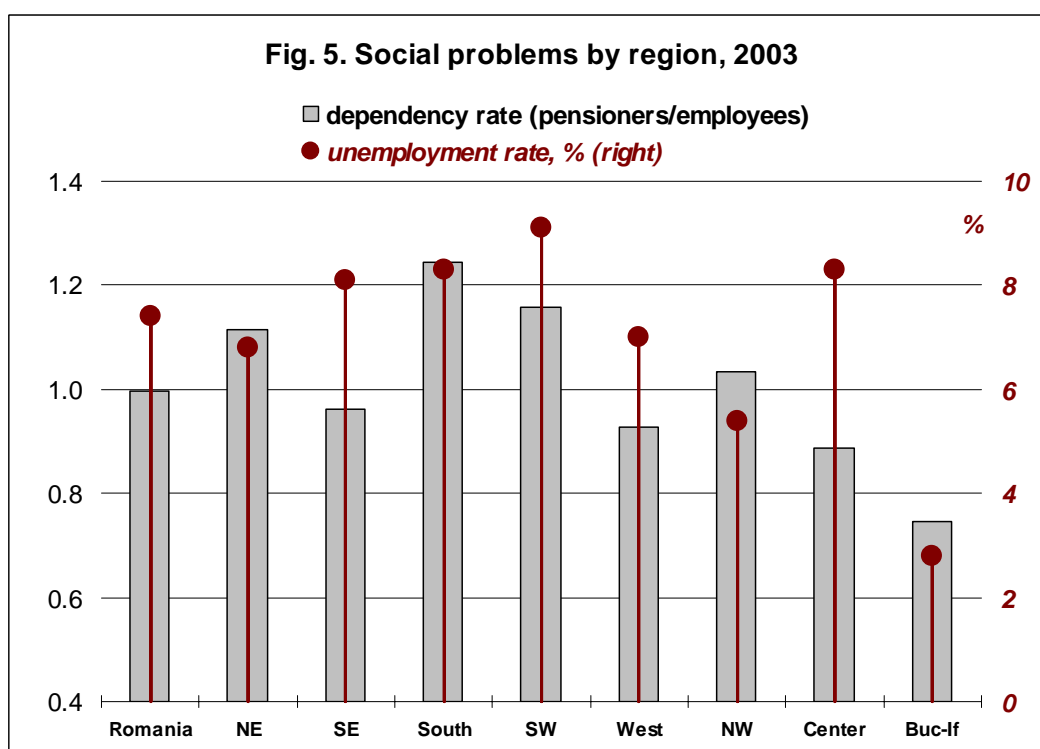
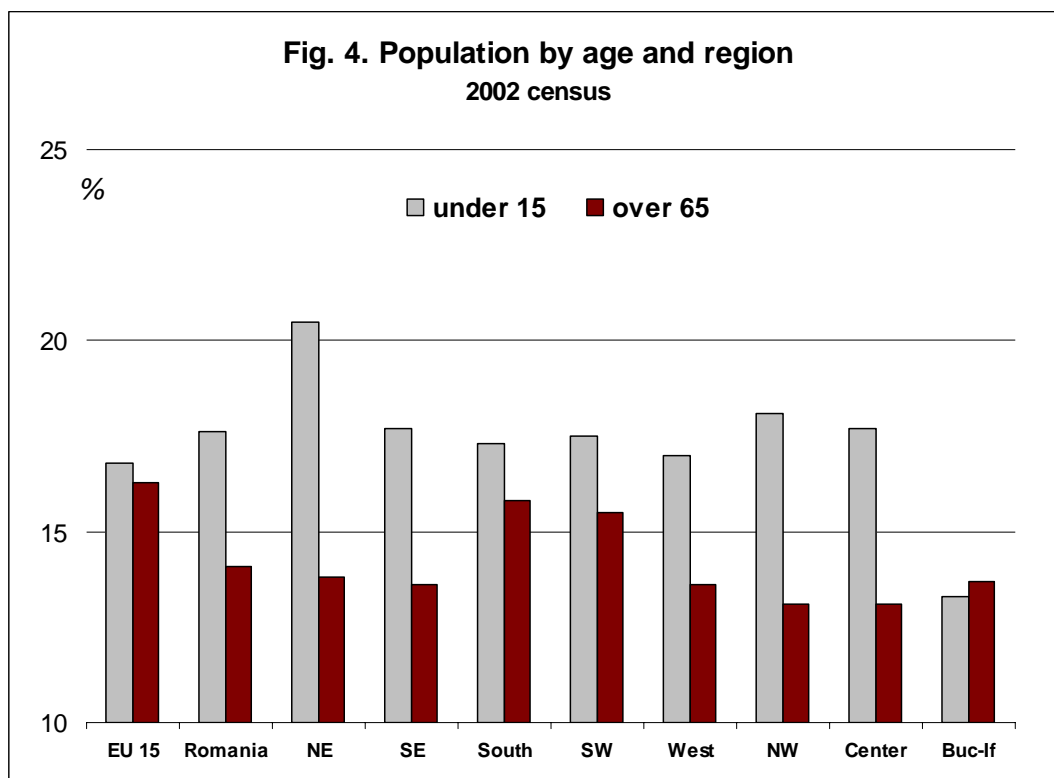


Demography reflects the changing socio-economic conditions in Romania during transition. There is a general decline of population, which is nothing new, due to the falling birthrate and emigration. The last factor plays an uncertain role in the long term, however: if most of those who left to work in the EU will return, the effect will be temporary; but if many of them settle down for good in Western Europe, statistics will register a substantial one-off drop in population in the early years of the decade. In any case, we can conclude that:

- The poorer North and East are more affected currently by the outflow of people, these being areas of highest external and internal emigration
- There was a reverse in the general, secular trend in urbanization during the transition, especially between 1994-2000, as many urban dwellers moved (back, most likely) to villages (Fig. 3). This was a subsistence strategy of blue collar workers confronted with massive industrial restructuring. Things look as if the forced urbanization under Communism led to a backlash immediately after the regime collapse. This stage is probably over.

The population aging is obvious especially in South and South West, where it is close to the European average (Fig. 4). Since the younger people still around are strongly attracted by the adjacent Region 8 (primarily Bucharest), a gradual depopulation of these areas is to be expected in the future. Which economically makes sense: as the previous section of this report shows, the consolidation of land and agro economic activities is a must, especially in the Romanian Plain. But the changes will be accompanied by social problems which require vision, determination and resources to be tackled. The policy of

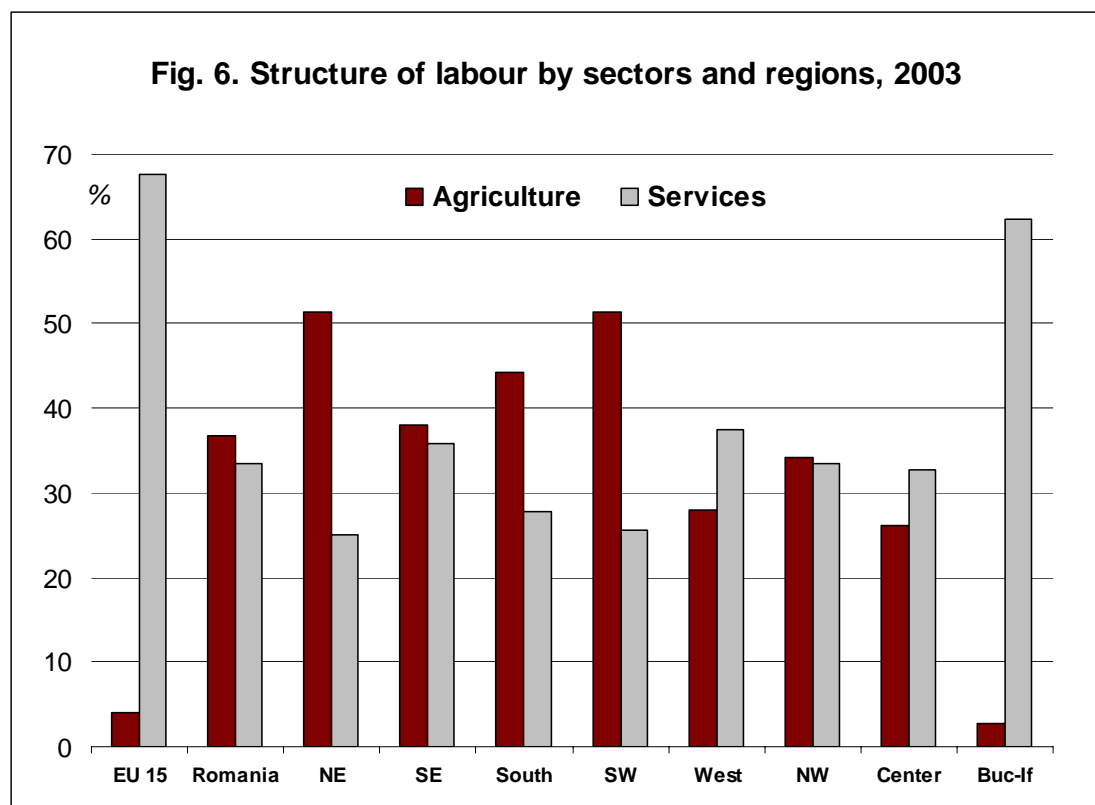
life annuities for old peasants in exchange for land, recently announced by the Ministry of Agriculture, may be such a bold measure. But every small detail of implementation must be clarified before moving on, in order to avoid the typical Romanian haste and lack of coordination in this sensitive domain. The compatibility with the European CAP must also be assured if we want to put EU money into the scheme.

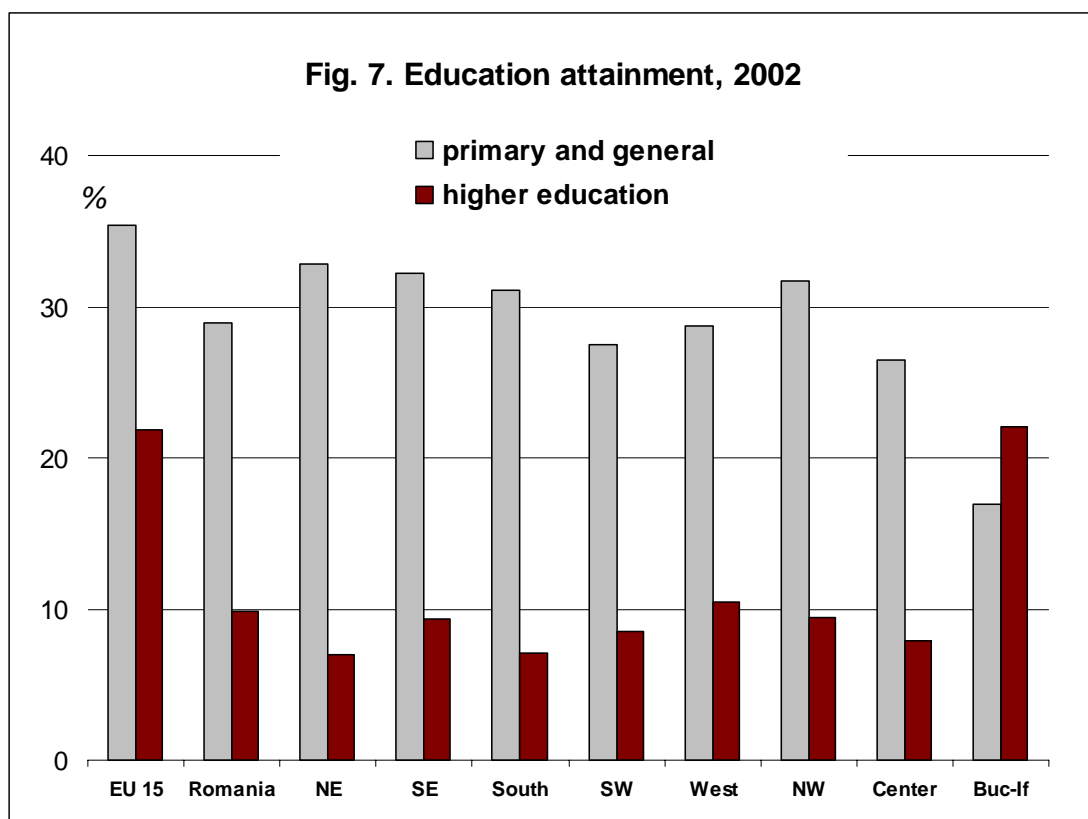


Unsurprisingly, the differential in aging trends is also reflected in the social dependency rate, which varies by region. Again, the southern parts are on top at the pensioners / employee ratio (Fig. 5).

Demographics and industrial decline have contributed to this result, as the Romanian governments were happy all along to camouflage the under-employment of people with low qualifications through early retirement and migration to the rural. The overall unemployment is quite low for a country undergoing massive economic reforms (Fig. 5), but this numbers do not account for the fact that many individuals of working age are practically unemployed who keep themselves busy around the house and the garden.

The future does not look much better, for the distribution of labor by sectors (Fig. 6) and the stock of human capital (Fig. 7) are not favorable for sustained development. Actually, Romania should look more like Region 8 to come close to the structure of the EU from this point of view, and this will not happen soon. In the problem regions it is even possible that the EU assistance remain without effect, as it is not clear if these communities have enough resources, energy and expertise to use it effectively.







# Republic of Moldova

## DILEMMAS IN CHIȘINĂU

### GUAM, Europe and the new trends in regional security policy

The shift of NATO borders on the Prut River after Romania became a full member in 2003 has not led to any visible changes of Moldovan official attitude toward the outside world. It has neither changed the regional balance of powers, which has been perpetuated in this region of Europe for the last ten years. Not much happened at domestic level either. The fact that the borders of the North Atlantic Alliance are only 100 km away from Chișinău does not seem to affect in any significant way the polarized politics of Moldova, considering that the territory laying East of Dniestr is being de facto controlled by Russian troops together with paramilitary troops of the breakaway regime in Tiraspol.

Nevertheless, the proliferation of both military and nonmilitary security threats in the area, especially due to the existence of an offshore criminal zone controlled by unconstitutional forces, raises concerns regarding the security and stability of this region not only for Moldova, but also for neighboring areas.

During the 2004 Istanbul summit, NATO formulated a clear strategy seeking to continuously adjust the Alliance to its new responsibilities, to the geopolitical changes that have prompted the war against terrorism as the number one priority, and to the existing cleavages generated by the Iraq war within the Alliance. As a general line, NATO decided to extend its area of responsibility according to American priorities, as USA remains the main supporter and financier of the organization. This big leap from the North-Atlantic to Middle Asia left Moldova again in an area of secondary interest for NATO. Any hopes regarding possible security arrangements for the South-West region of the former Soviet Union have thus once more proved vain.

However, recent geo-strategic and political developments, focused on making the Black Sea area more secure, offer interesting perspectives to the Republic of Moldova, in its quest for re-establishing its territorial integrity and for obtaining sustainable guarantees. New NATO members, such as Romania and Bulgaria, but also old ones like Turkey, could play an important, if not decisive role, in designing new partnerships in the region. The transnational character of most of the threats stemming from this area, such as arms smuggling, human

**Romania's joining of NATO has not produced significant effects in Chișinău**

trafficking, proliferation of WMDs, as well as organized crime possibly associated with terrorism, require a more established and sustainable cooperation of those states affected by these phenomena. The reshaping of security arrangements in the Black Sea area is still at its beginning, however, and only time will show how effective this quest of extending security guarantees outside the traditional area of responsibility of NATO allies could be.

In the meanwhile, the reactivation of older regional security arrangements in the post-soviet space seems to become a new trend in the attempt to guarantee collective security. In this respect, the GUAM summit in Chişinău in April 22 opened a new stage in transforming this organization into an institution capable of promoting the interests of its member states in their delicate relationship with Russia, as well as in their efforts to re-integrate in the Euro-Atlantic community.

### **GUAM: the stage of self-assertion**

The relative short existence of GUAM as a regional organization can be divided in two stages. The initial one begun eight or nine years ago, when four newly independent states – Georgia, Ukraine, Azerbaijan and Moldova – had the initiative to coordinate their efforts in order to consolidate their energy and economic independence, as well as their sovereignty, by developing their bilateral relations and by strengthening their relationship with the Euro-Atlantic community.

This initiative came as a reaction to the inefficiency and inability of the Russian-dominated CIS to solve any of the serious problems faced by these states. Such problems related especially to the one-sided economic and energy dependency on Eastern markets, as well as to the territorial separatism and the presence of foreign military troops on their territory, which perpetuated a chronic situation of uncertainty and insecurity. The breakaway regimes had created – with tacit Russian approval – criminal offshore zones, which became with time the source of all kind of military and non-military threats and hindered the normalization and stabilization of the domestic environment in these countries.

This first stage of GUAM existence was seriously marked by former soviet leaders such as Shevarnadze, Kuchma, Aliiev senior and Luchinsky, with their specific traditional attitude towards the relationships within the new organization, as well as towards international problems more generally. As representatives of the former nomenklatura, these leaders promoted a very vague foreign policy, by balancing all the time between Moscow, Washington and Brussels, while preserving equal distance from both West and East. This proved to be an unproductive policy, as it managed to preserve uncertainty in these countries and did not succeed in attracting Western interest for this region. GUAM has thus failed in creating for itself any efficient mechanisms of action, and most of the decisions met by the high representatives of member states remained only on paper. As such, the new organization increasingly resembled to a smaller CIS.

Starting with 2003 the domestic situation in most of the GUAM member states changed radically. One by one, these countries announced that their major strategic goal was to get back to Europe, and adjusted accordingly their foreign policies in order to strengthen their relations with both NATO and the EU. Geopolitical changes also occurred after 2003. The borders of the Transatlantic Alliance shifted to the East, touching the western borders of the former Soviet Union, and became the immediate neighbor of Russia in the Baltic Sea area. At the same time, the Russian Federation declared its "immediate neighborhood" as an area of special interest, while the United States affirmed its clear intentions of stabilizing the situation in the Black Sea and Caspian Sea basins in order to consolidate its presence there and to increase the efficiency of its antiterrorism instruments. Equally important, the USA shows an increasing interest in these areas because it seeks to ensure safe access to the important energy resources in this region. The EU interest in this sub-regional organization has also increased since 2003, as shown by the "Wider Europe" strategy, as well as by the enhanced European efforts for securing its new Eastern borders.

**GUAM was a means by which post-soviet elites have postponed clear-cut decisions**

The domestic developments in Georgia, Ukraine and Moldova, coupled with the geopolitical changes that occurred in the area, have generated the need for a stronger cooperation between GUAM member states. This regional project was re-launched also because of the recent rapprochement between the GUAM member states, based on their common long-term strategic interests, as well as common threats towards their sovereignty and independence. All these factors have led to the start of a new stage in the existence of GUAM.

The major goals of GUAM were announced with the occasion of the summit in Chişinău: consolidating the independence and sovereignty of its member states by countering territorial separatism, creating a free trade area, ensuring a higher level of energy security and exiting the Russian sphere of influence. Of course, none of these countries is able to effectively promote and defend its interest by itself, and assuring national security within the existent environment is impossible without international support from strategic partners. Such problems could only be solved within greater alliances and with the support of important international actors.

### **The GUAM format: possible changes and reactions**

The final configuration of GUAM depends to a great extent on its geopolitical dimension. For the time being, GUAM is a voluntary association of states from South Caucasus up to Ukraine (with the exception of Armenia), which all remain CIS members, while at the same time trying to promote a pro-European foreign policy, as well as cooperation with Western international organizations. The withdrawal of Uzbekistan from this association was predictable in this sense, because of the incompatibility between President Karimov's policies and the democratic values, embraced – at least according to official declarations – by the rest of the GUAM members.

GUAM has therefore the chance to stand today as an important element of this regional system, which seeks to guarantee security and stability in the new Eastern Europe and the Black Sea area. The organization is currently going through a re-configuration process, and much will depend on its cooperation with neighboring states, NATO member states and the Alliance as a whole, as well as the EU.

Romania is starting to play an increasingly visible and important role in the region. Since the 2004 November elections, the newly elected President Traian Băsescu has been promoting a clear and structured foreign policy with regard to Romania's role in modern Europe. In this respect, the stabilization of the Black Sea area by countering territorial separatism and settling the frozen conflicts in the region has been announced as one of the top priorities of Romanian foreign policy. Bucharest becomes therefore one of the most important strategic partners of GUAM member states.

There is no big secret that the US have contributed since 1996-1997 to the creation of this organization and supported it politically. Therefore, it is natural that GUAM member states think of the United States as of an essential strategic partner in their quest of consolidating democracy and independency, as well as that of regaining territorial integrity in the case of Moldova, Georgia and Azerbaijan. The partnership between GUAM and the US is based on their common interests in consolidating democracy and securitizing the Eastern European space.

The EU might gradually also start to formulate a more clear and affirmative foreign policy towards this area, as an element of its still underdeveloped Common Foreign and Security Policy (CFSP), hindered by the lack of mechanisms to implement any decision. However, for the time being, there is no partner other than the United States able to support these countries and counter the neo-imperial Russian tendencies.

**Post-imperial  
syndrome still  
makes victims  
in Eurasia**

The Russian Federation is one of the most important factors in this equation, and may also influence to a great extent the future shape of GUAM. Moscow reacts negatively to any initiative of the former "sister republics", which has not been previously agreed in Kremlin. Such reactions become completely irrational whenever these new independent states try to assert their sovereignty and consolidate their efforts in order to promote their common interests. This is a symptom of the Russian post-imperial syndrome, which seems to be widely spread in Eurasia. Most of the Russian politicians, commentators or analysts, see this effort of re-launching GUAM as a way of extending the Western sphere of influence in what they perceive as the "immediate neighborhood" of Russia. This attitude shows a certain inferiority complex of most Russian leaders, as well as distrust in their Western partners. Indeed, since 2001 Russia has become an important partner of the US in its fight against terrorism. At the same time, Russia remains a nuclear power and is one of the key players in the efforts to counter the proliferation of WMDs or WMD's components. These are important reasons for which the United States tends to be sensible to what

Kremlin leaders have to say on certain issues and promotes a balanced policy in what concerns the support given to the new neighbors of NATO and the EU.

The last round of NATO enlargement has generated a pretty strong Russian reaction, as Moscow is trying to put some distance between itself and the West by creating a belt of former soviet republics around its borders. These republics are seen by Russian leaders as quiet, docile elements in the wider geopolitical quest of creating a new order within the Eurasian space.

Ukraine plays an important role in this game. Recent domestic political developments have shown that Ukraine is not willing to play docile for Moscow any more, and Russia cannot restore its empire without Ukraine, as nationalistic leaders in Moscow would like. On the other hand, wider Europe cannot remain stable either without Ukraine. Since coming to power, the pro-Western President Yuschcenko has been declaring Ukraine's interest in joining the Euro-Atlantic institutions and has shown the will to take a decisive stance in the settlement of the Transnistrian conflict in Moldova, which indicates a radical geopolitical change in the region.

Finally, but not least, the structure and future of GUAM depends to a large extent on the ability of its member states to assume responsibility for guaranteeing stability and security in the region, to mobilize their efforts in order to address common problems, as well as to show solidarity and efficiency when promoting their interests in front of international actors active in the region.

### **Moldova – The Immediate Neighbor of NATO and the EU**

The effects of Romania joining the EU in 2007 will be beneficial for GUAM, and especially for the Republic of Moldova, as they would become the immediate neighbors of an influential and important centre of power. This should enhance dialogue, economic partnerships and bilateral relations. For the time being, the Republic of Moldova is placed in Europe's neighborhood according to the New Neighborhood Policy of the European Union, but the fulfillment of the EU Action Plan for Moldova would offer this country a real chance to step into a different stage in its relationship with the EU.

However, the shift of EU borders on the Prut river will most probably not generate immediate positive effects for the Moldovan Republic. Romania has already been a NATO member for more than one year, but the fact that the border of North-Atlantic Alliance is only 100 km away from Chişinău did not bring many changes until now. It has clearly not helped in addressing the major problem of Transnistria, a "black hole" and a source of both military and human security threats in Eastern Moldova. The normalization of Moldova-Romania relationships, the unconditional support offered by Romania in Moldova's quest to join the EU, as well as the positive involvement of Romania in the settlement of the Transnistrian conflict have created the premises of a closer involvement of NATO and the EU in Chişinău's problems.

The possibility of Ukraine joining NATO should also be taken into account. Since Yuschenko entered office, there have been voices saying this might be possible through a very expedient, special procedure. In any case, provided that Ukraine maintains its pro-Western orientation within a rather stable political environment at domestic level, Moldova and Ukraine could be dealt with as a group by the EU and NATO. Moldova should nevertheless also continue its individual path towards Europe, in order to make sure that its interests would not be hurt by possible radical foreign policy changes of its partners.

Moldova has not yet formulated clear directions for its future relationship with NATO. A natural step in developing this relation would be to shift from the current PfP Framework, which has been rendered obsolete with time, to a NATO-Moldova individual cooperation plan adapted to the present geopolitical circumstances, as well as to Moldova's intentions to join the Euro-Atlantic structures. Such a plan should contain a special chapter regarding the settlement of the Transnistrian conflict, as well as a chapter regarding the assistance provided by the Allies for the normalization of the situation of all "frozen conflicts" in South-East Europe and South Caucasus. NATO remains the only security organization in the area, which may have the flexibility and experience, as well as the infrastructure necessary to guarantee security in a region, which is still far from being stabilized.

**Moldova's  
neutrality  
between West  
and East is an  
anachronism**

Unfortunately, the Moldovan political class elite remains hostage to old soviet-time stereotypes and seems attracted to simple and irrelevant attitudes, such as the idea of the permanent neutrality of Moldova, stated within the Constitution. This constitutes a formal barrier towards a closer relation with NATO. The principle of Moldovan neutrality was embraced by the domestic political elite in the early 1990s, and was turned into official foreign policy by the Agrarian Democratic Party (ADP) in 1994. The ADP and the coalition governing the country at that time proved unable to understand the international developments in Europe and promoted almost exclusively the integration into CIS. Indeed, during the Cold War, this idea of neutrality represented a compromise between great powers interested in maintaining the balance of power in Europe, and helped the young Moldovan state to explain its refusal to join the CIS Collective Security Agreement. However, neutrality is not relevant any more under the new geopolitical circumstances, as it only makes such states fall into a "grey zone of indifference". Moreover, the idea of neutrality ended in serving as an excuse for post-soviet political elites, who were not willing – or able – to take decisive decisions to ensure the military security of the Moldovan state. As long as Moldova does not revise its neutrality status, it will remain squeezed between East and West, with no real prospect of escaping this dilemma. Joining NATO and getting closer to the EU can only happen when the Moldovan political class understands that NATO is nothing else than an institution guaranteeing security for its member countries.

## **GUAM and the Breakaway Statelets**

All GUAM member states, except Ukraine, face serious threats to their sovereignty because of breakaway statelets functioning on their territories. The Republic of Moldova was the first of these countries, which was provided an offer by its GUAM partners. This offer consisted in the seven principles (steps) announced by President Yuschcenko during the Chişinău summit. Unfortunately, this initiative was not very welcome, as it did not provide for a clear, coherent plan, but rather for a set of principles, which should guide the settlement of the Transnistrian conflict. This actually proved that the Kyiv administration had no clear concept on how to address this frozen conflict. Just a few weeks later, it was made clear by some well-known commentators from Moldova and abroad that this initiative was nothing more than an effort of certain interest groups from President Yuschcenko's circle to distort the settlement process and maintain the status quo of uncertainty at the Ukrainian border with Moldova. At the same time, Ukraine seems to try and affirm itself as an undisputed leader of GUAM, taking unilateral initiatives in solving the internal problems of other member states, without prior consultation with the state concerned.

A general conclusion would be that Moldova should come up as soon as possible with a concrete plan for the settlement of the Transnistrian conflict. This would require a coherent strategy, based on principles, but also on a comprehensive and realistic list of available resources. The strategy should also refer to the instruments needed and the actions planned for reaching the territorial and political integrity of the Moldovan state. In order to achieve this, Moldova also needs a strategic partnership, which would help her counter the negative Russian interference in Transnistria.

No matter what, there are a few preconditions that have to be met in order to settle this conflict. A first precondition refers to closing the Moldo-Ukrainian border on the Transnistrian segment. Second, Russian troops should withdraw immediately and unconditionally from the region and the composition of peacekeeping troops on the cease-fire line should be revised. Thirdly, a new negotiating format should be implemented to replace the existing defective pentagonal format, which only contributed to freezing the conflict.

In this respect, the recent declaration of OSCE Ambassador to Moldova, William Hill, that Transnistrian separatists offer economic benefits to regional elites, is of much significance. This is actually a phenomenon that needs no proof any more. President Voronin himself referred repeatedly to the efforts made by Transnistrian leaders to pay money in order to assure a safe environment for organized illegal business. These leaders actually need the support of certain influential circles so that the status-quo at the Moldo-Ukrainian border is preserved, as this is their main financing source. This fact was proved by certain such Ukrainian and Russian circles, who oppose any Moldovan initiative of settling the conflict. Organized crime groups are also interested in preserving this off-shore criminal zone, which they use for money laundering, as well as human and goods trafficking.

## The Republic of Moldova and its European prospects

The well-known analyst Vladimir Socor declared recently that the EU integration of the Republic of Moldova remains a distant perspective, because Moldova is unattractive for the EU today due to its defective governance during the last fifteen years. It is clear indeed that there are still many changes needed in order to make the Republic of Moldova attractive for the EU. However, GUAM could now play the role of a second "Visegrad Group" under the new geopolitical circumstances, which would bring its member states *in corpore* closer to the European Union.

For the time being, it is much clearer what the Republic of Moldova should NOT do if it wants to avoid any other difficulties in joining the EU. First of all, there is a risk that the Moldovan political elite continue to see this rapprochement process to EU as a rather diplomatic one, or as an exclusive foreign policy process. Secondly, there is also the danger of adopting a pure bureaucratic, centralist way of implementing action plans, while excessively politicizing Moldova's Europeanization. At the same time, there is a tendency to overestimate Moldova's capacity to implement these plans in a very short time, which actually indicated the how superficial the attitude of the political elite is with respect to the complexity of its commitments toward Brussels.

**Moldova's rapprochement with the EU risks being perceived merely as a foreign policy matter – not as a comprehensive effort to reform the state, as it should**

The major problem when talking about Moldova's EU integration consists in creating the adequate internal premises that would allow the Moldovan society to embrace the democratic European values and become a modern, Western-like society. This would need again a clear and comprehensive strategy, which would underline some of the key economic, social and political steps to be taken in the immediate future. However, restructuring the economy would need foreign investment, and Moldova is not yet very attractive to foreign investors, while the financial European support comes only as assistance, and not as investment. At the same time, Moldova remains an electoral, rather declarative democracy, and needs time to become a functional democracy. The Moldovan society is only at the stage of trying to establish rule of law, an independent justice and a free, accountable mass media. These are only some of the many elements, which require serious efforts on behalf of the Moldovan society, based on a coherent strategy and on clear, achievable goals. Unfortunately, there is not much progress to be observed in this direction, while the exaggerated optimism of Moldovan officials does not look very promising. The Republic of Moldova together with the other GUAM states need to concentrate all their efforts to transform this vicious circle of unsettled problems and uncertainty into a virtuous circle, which would allow them to return to the European family.



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